

# AEP Generating Company

2010 Annual Report

Financial Statements



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## GLOSSARY OF TERMS

When the following terms and abbreviations appear in the text of this report, they have the meanings indicated below.

<b>Term</b>	<b>Meaning</b>
AEGCo	AEP Generating Company, an AEP electric utility subsidiary.
AEP or Parent	American Electric Power Company, Inc.
AEP System or the System	American Electric Power System, an integrated electric utility system, owned and operated by AEP's electric utility subsidiaries.
AEPSC	American Electric Power Service Corporation, a service subsidiary providing management and professional services to AEP and its subsidiaries.
AFUDC	Allowance for Funds Used During Construction.
CO <sub>2</sub>	Carbon Dioxide and other greenhouse gases.
CSPCo	Columbus Southern Power Company, an AEP electric utility subsidiary.
CWIP	Construction Work in Progress.
EIS	Energy Insurance Services, Inc., a nonaffiliated captive insurance company.
Federal EPA	United States Environmental Protection Agency.
FERC	Federal Energy Regulatory Commission.
I&M	Indiana Michigan Power Company, an AEP electric utility subsidiary.
KPCo	Kentucky Power Company, an AEP electric utility subsidiary.
MW	Megawatt.
Rockport Plant	A generating plant, consisting of two 1,300 MW coal-fired generating units near Rockport, Indiana.
UPA	Unit Power Agreement.
Utility Money Pool	AEP System's Utility Money Pool.
VIE	Variable Interest Entity.

## INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholder of  
AEP Generating Company:

We have audited the accompanying balance sheets of AEP Generating Company (the "Company") as of December 31, 2010 and 2009, and the related statements of income, changes in common shareholder's equity, and cash flows for each of the three years in the period ended December 31, 2010. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of AEP Generating Company as of December 31, 2010 and 2009, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2010, in conformity with accounting principles generally accepted in the United States of America.

/s/ Deloitte & Touche LLP

Columbus, Ohio  
February 25, 2011

**AEP GENERATING COMPANY**  
**STATEMENTS OF INCOME**  
For the Years Ended December 31, 2010, 2009 and 2008  
(in thousands)

	<u>2010</u>	<u>2009</u>	<u>2008</u>
<b>OPERATING REVENUES</b>	\$ 450,780	\$ 414,793	\$ 468,275
<b>EXPENSES</b>			
Fuel Used for Electric Generation	249,278	216,004	273,935
Rent - Rockport Plant Unit 2	68,283	68,283	68,283
Other Operation	31,825	25,140	24,838
Maintenance	16,018	21,381	14,681
Depreciation and Amortization	36,837	34,631	33,511
Taxes Other Than Income Taxes	4,090	4,435	3,904
<b>TOTAL EXPENSES</b>	<u>406,331</u>	<u>369,874</u>	<u>419,152</u>
<b>OPERATING INCOME</b>	44,449	44,919	49,123
<b>Other Income (Expense):</b>			
Other Income	127	5,118	6,339
Interest Expense	<u>(16,713)</u>	<u>(16,100)</u>	<u>(16,203)</u>
<b>INCOME BEFORE INCOME TAX EXPENSE</b>	27,863	33,937	39,259
Income Tax Expense	<u>9,223</u>	<u>5,146</u>	<u>7,692</u>
<b>NET INCOME</b>	<u>\$ 18,640</u>	<u>\$ 28,791</u>	<u>\$ 31,567</u>

*The common stock of AEGCo is wholly-owned by AEP.*

*See Notes to Financial Statements.*

**AEP GENERATING COMPANY**  
**STATEMENTS OF CHANGES IN COMMON SHAREHOLDER'S EQUITY**  
For the Years Ended December 31, 2010, 2009 and 2008  
(in thousands)

	Common Stock	Paid-in Capital	Retained Earnings	Total
<b>TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2007</b>	\$ 1,000	\$ 190,434	\$ 34,722	\$ 226,156
Capital Contribution from Parent		42,750		42,750
Common Stock Dividends			(12,000)	(12,000)
<b>SUBTOTAL – COMMON SHAREHOLDER'S EQUITY</b>				256,906
<b>COMPREHENSIVE INCOME</b>				
<b>NET INCOME</b>			31,567	31,567
<b>TOTAL COMPREHENSIVE INCOME</b>				31,567
<b>TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2008</b>	1,000	233,184	54,289	288,473
Capital Contribution from Parent		5,000		5,000
Common Stock Dividends			(24,500)	(24,500)
<b>SUBTOTAL – COMMON SHAREHOLDER'S EQUITY</b>				268,973
<b>COMPREHENSIVE INCOME</b>				
<b>NET INCOME</b>			28,791	28,791
<b>TOTAL COMPREHENSIVE INCOME</b>				28,791
<b>TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2009</b>	1,000	238,184	58,580	297,764
Common Stock Dividends			(20,000)	(20,000)
<b>SUBTOTAL – COMMON SHAREHOLDER'S EQUITY</b>				277,764
<b>COMPREHENSIVE INCOME</b>				
<b>NET INCOME</b>			18,640	18,640
<b>TOTAL COMPREHENSIVE INCOME</b>				18,640
<b>TOTAL COMMON SHAREHOLDER'S EQUITY – DECEMBER 31, 2010</b>	\$ 1,000	\$ 238,184	\$ 57,220	\$ 296,404

See Notes to Financial Statements.

**AEP GENERATING COMPANY**  
**BALANCE SHEETS**  
**ASSETS**  
**December 31, 2010 and 2009**  
**(in thousands)**

	<b>2010</b>	<b>2009</b>
<b>CURRENT ASSETS</b>		
Accounts Receivable - Affiliated Companies	\$ 57,278	\$ 37,958
Fuel	46,422	50,004
Materials and Supplies	17,484	15,994
Accrued Tax Benefits	1,297	15,774
Prepayments and Other Current Assets	802	467
<b>TOTAL CURRENT ASSETS</b>	<b>123,283</b>	<b>120,197</b>
<b>PROPERTY, PLANT AND EQUIPMENT</b>		
Electric:		
Generation	1,455,131	1,443,263
Transmission	9,688	9,688
Other Property, Plant and Equipment	8,739	7,820
Construction Work in Progress	228,794	227,315
<b>Total Property, Plant and Equipment</b>	<b>1,702,352</b>	<b>1,688,086</b>
Accumulated Depreciation and Amortization	881,682	848,696
<b>TOTAL PROPERTY, PLANT AND EQUIPMENT – NET</b>	<b>820,670</b>	<b>839,390</b>
<b>OTHER NONCURRENT ASSETS</b>		
Regulatory Assets	16,694	14,429
Deferred Charges and Other Noncurrent Assets	2,069	2,489
<b>TOTAL OTHER NONCURRENT ASSETS</b>	<b>18,763</b>	<b>16,918</b>
<b>TOTAL ASSETS</b>	<b>\$ 962,716</b>	<b>\$ 976,505</b>

*See Notes to Financial Statements.*

**AEP GENERATING COMPANY**  
**BALANCE SHEETS**  
**LIABILITIES AND SHAREHOLDER'S EQUITY**  
**December 31, 2010 and 2009**

	<b>2010</b>	<b>2009</b>
<b>CURRENT LIABILITIES</b>	<b>(in thousands)</b>	
Advances from Affiliates	\$ 21,178	\$ 80,168
Accounts Payable:		
General	15,458	1,278
Affiliated Companies	67,698	32,175
Long-term Debt Due Within One Year – Nonaffiliated	137,273	7,273
Accrued Taxes	9,934	4,692
Accrued Rent - Rockport Plant Unit 2	4,963	4,963
Other Current Liabilities	4,958	4,890
<b>TOTAL CURRENT LIABILITIES</b>	<b>261,462</b>	<b>135,439</b>
<b>NONCURRENT LIABILITIES</b>		
Long-term Debt – Nonaffiliated	189,074	326,314
Deferred Income Taxes	65,372	64,443
Regulatory Liabilities and Deferred Investment Tax Credits	54,746	56,127
Deferred Gain on Sale and Leaseback - Rockport Plant Unit 2	66,479	72,050
Deferred Credits and Other Noncurrent Liabilities	29,179	24,368
<b>TOTAL NONCURRENT LIABILITIES</b>	<b>404,850</b>	<b>543,302</b>
<b>TOTAL LIABILITIES</b>	<b>666,312</b>	<b>678,741</b>
Commitments and Contingencies (Note 3)		
<b>COMMON SHAREHOLDER'S EQUITY</b>		
Common Stock – Par Value – \$1,000 Per Share:		
Authorized – 1,000 Shares		
Outstanding – 1,000 Shares	1,000	1,000
Paid-in Capital	238,184	238,184
Retained Earnings	57,220	58,580
<b>TOTAL COMMON SHAREHOLDER'S EQUITY</b>	<b>296,404</b>	<b>297,764</b>
<b>TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY</b>	<b>\$ 962,716</b>	<b>\$ 976,505</b>

*See Notes to Financial Statements.*

**AEP GENERATING COMPANY**  
**STATEMENTS OF CASH FLOWS**  
For the Years Ended December 31, 2010, 2009 and 2008  
(in thousands)

	<u>2010</u>	<u>2009</u>	<u>2008</u>
<b>OPERATING ACTIVITIES</b>			
<b>Net Income</b>	\$ 18,640	\$ 28,791	\$ 31,567
<b>Adjustments to Reconcile Net Income to Net Cash Flows from Operating Activities:</b>			
Depreciation and Amortization	36,837	34,631	33,511
Deferred Income Taxes	(479)	27,884	(2,277)
Deferred Investment Tax Credits	(3,282)	(3,282)	(3,272)
Amortization of Deferred Gain on Sale and Leaseback - Rockport Plant Unit 2	(5,571)	(5,571)	(5,570)
Allowance for Equity Funds Used During Construction	(123)	(5,175)	(6,198)
Change in Other Noncurrent Assets	2,506	5,053	1,062
Change in Other Noncurrent Liabilities	2,056	6,200	119
<b>Changes in Certain Components of Working Capital:</b>			
Accounts Receivable	(19,092)	(93)	(1,653)
Fuel, Materials and Supplies	2,092	(18,018)	9,867
Accounts Payable	49,454	850	(3,026)
Accrued Taxes, Net	20,140	(14,107)	221
Other Current Assets	(199)	(77)	34
Other Current Liabilities	(188)	(1,702)	1,387
<b>Net Cash Flows from Operating Activities</b>	<u>102,791</u>	<u>55,384</u>	<u>55,772</u>
<b>INVESTING ACTIVITIES</b>			
Construction Expenditures	(16,674)	(61,622)	(116,774)
Proceeds from Sales of Assets	522	-	-
<b>Net Cash Flows Used for Investing Activities</b>	<u>(16,152)</u>	<u>(61,622)</u>	<u>(116,774)</u>
<b>FINANCING ACTIVITIES</b>			
Capital Contribution from Parent	-	5,000	42,750
Issuance of Long-term Debt – Nonaffiliated	-	-	84,464
Change in Advances from Affiliates, Net	(58,990)	33,368	(46,591)
Retirement of Long-term Debt – Nonaffiliated	(7,273)	(7,273)	(7,273)
Principal Payments for Capital Lease Obligations	(376)	(357)	(348)
Dividends Paid on Common Stock	(20,000)	(24,500)	(12,000)
<b>Net Cash Flows from (Used for) Financing Activities</b>	<u>(86,639)</u>	<u>6,238</u>	<u>61,002</u>
<b>Net Change in Cash and Cash Equivalents</b>	-	-	-
<b>Cash and Cash Equivalents at Beginning of Period</b>	-	-	-
<b>Cash and Cash Equivalents at End of Period</b>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
<b>SUPPLEMENTARY INFORMATION</b>			
Cash Paid for Interest, Net of Capitalized Amounts	\$ 16,213	\$ 15,542	\$ 15,512
Net Cash Paid (Received) for Income Taxes	(7,221)	(3,104)	12,521
Noncash Acquisitions Under Capital Leases	104	6	13
Construction Expenditures Included in Accounts Payable at December 31,	386	137	10,997

See Notes to Financial Statements.

## **INDEX OF NOTES TO FINANCIAL STATEMENTS**

1. Organization and Summary of Significant Accounting Policies
2. Effects of Regulation
3. Commitments, Guarantees and Contingencies
4. Business Segments
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## **1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

### **ORGANIZATION**

AEGCo engages in the generation and wholesale sale of electric power to its affiliates, CSPCo, I&M and KPCo. AEGCo and I&M co-own Unit 1 of the Rockport Plant. Unit 2 of the Rockport Plant is owned by a third party and leased to I&M and AEGCo. I&M operates the Rockport Plant. AEGCo derives operating revenues from the sale of Rockport Plant energy and capacity to I&M and KPCo pursuant to FERC-approved long-term unit power agreements through December 2022. Under the terms of its unit power agreement, I&M agreed to purchase all of AEGCo's Rockport energy and capacity unless it is sold to other utilities or affiliates. I&M assigned 30% of its rights to energy and capacity to KPCo.

In 2007, AEGCo completed the purchase of the Lawrenceburg Generating Station (Lawrenceburg), a combined-cycle, natural-gas power plant. CSPCo and AEGCo entered into a 10-year UPA for the entire output from the plant effective with AEGCo's purchase of Lawrenceburg. The UPA has an option for an additional 2-year period. I&M operates the plant under an agreement with AEGCo. Under the UPA, CSPCo pays AEGCo for the capacity, depreciation, fuel, operation and maintenance and tax expenses. These payments are due regardless of whether the plant is operating. The fuel and operation and maintenance payments are based on actual costs incurred. All expenses are trued up periodically.

The unit power agreements provide for a FERC-approved rate of return on common equity, a return on other capital (net of temporary cash investments) and recovery of costs including operation and maintenance, fuel and taxes. Under the terms of the unit power agreements, AEGCo accumulates all expenses monthly and prepares bills for its affiliates. In the month the expenses are incurred, AEGCo recognizes the billing revenues and establishes a receivable from the affiliated companies. The costs of operating the plants are billed to the respective parties of the agreements.

In 2007, AEGCo purchased the partially completed Dresden Plant. During 2009, AEGCo suspended construction of the Dresden Plant as part of AEP's overall response to the economic conditions in 2009. As a result, AEGCo stopped recording AFUDC. AEGCo resumed construction in the first quarter of 2011 and will resume recording AFUDC. Through December 31, 2010, AEGCo incurred \$95 million in construction costs (excluding AFUDC) at the Dresden Plant. The Dresden Plant is located near Dresden, Ohio and is a natural gas, combined cycle power plant. When completed, the Dresden Plant will have a generating capacity of 580 MW.

### **SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### ***Rates and Service Regulation***

The FERC regulates AEGCo's rates and affiliated transactions, including AEPSC intercompany service billings which are generally at cost, under the 2005 Public Utility Holding Company Act and the Federal Power Act. The FERC also has jurisdiction over the issuances and acquisitions of securities of the public utility subsidiaries, the acquisition or sale of certain utility assets and mergers with another electric utility or holding company. For non-power goods and services, the FERC requires that a nonregulated affiliate can bill an affiliated public utility company no more than market while a public utility must bill the higher of cost or market to a nonregulated affiliate.

The FERC regulates wholesale power markets and wholesale power transactions. AEGCo's wholesale power transactions are generally cost-based regulated under FERC approved unit power agreements. Both the FERC and state regulatory commissions are permitted to review and audit the relevant books and records of companies within a public utility holding company system.

#### ***Accounting for the Effects of Cost-Based Regulation***

As a rate-regulated electric public utility company, AEGCo's financial statements reflect the actions of regulators that result in the recognition of certain revenues and expenses in different time periods than enterprises that are not rate-regulated. In accordance with accounting guidance for "Regulated Operations," AEGCo records regulatory assets (deferred expenses) and regulatory liabilities (future revenue reductions or refunds) to reflect the economic effects of regulation by matching expenses with their recovery through regulated revenues and income with its passage to customers through the reduction of regulated revenues.

### ***Use of Estimates***

The preparation of these financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. These estimates include, but are not limited to, inventory valuation, long-lived asset impairment, the effects of regulation, long-lived asset recovery and the effects of contingencies. The estimates and assumptions used are based upon management's evaluation of the relevant facts and circumstances as of the date of the financial statements. Actual results could ultimately differ from those estimates.

### ***Cash and Cash Equivalents***

Cash and Cash Equivalents on the Statements of Cash Flows include temporary cash investments with original maturities of three months or less.

### ***Inventory***

Fossil fuel inventories and materials and supplies inventories are carried at average cost.

### ***Property, Plant and Equipment***

Electric utility property, plant and equipment are stated at original purchase cost. Additions, major replacements and betterments are added to the plant accounts. Normal and routine retirements from the plant accounts, net of salvage, are charged to accumulated depreciation under the group composite method of depreciation. The group composite method of depreciation assumes that on average, asset components are retired at the end of their useful lives and thus there is no gain or loss. The equipment in each primary electric plant account is identified as a separate group. Under the group composite method of depreciation, continuous interim routine replacements of items such as boiler tubes, pumps, motors, etc. result in the original cost, less salvage, being charged to accumulated depreciation. The depreciation rates that are established take into account the past history of interim capital replacements and the amount of salvage received. These rates and the related lives are subject to periodic review. Removal costs are charged to regulatory liabilities. The costs of labor, materials and overhead incurred to operate and maintain the plants are included in operating expenses.

Long-lived assets are required to be tested for impairment when it is determined that the carrying value of the assets may no longer be recoverable or when the assets meet the held for sale criteria under the accounting guidance for "Impairment or Disposal of Long-lived Assets."

The fair value of an asset or investment is the amount at which that asset or investment could be bought or sold in a current transaction between willing parties, as opposed to a forced or liquidation sale. Quoted market prices in active markets are the best evidence of fair value and are used as the basis for the measurement, if available. In the absence of quoted prices for identical or similar assets or investments in active markets, fair value is estimated using various internal and external valuation methods including cash flow analysis and appraisals.

### ***Allowance for Funds Used During Construction (AFUDC)***

AFUDC represents the estimated cost of borrowed and equity funds used to finance construction projects that is capitalized and recovered through depreciation over the service life of regulated electric utility plant. AEGCo records the equity component of AFUDC in Other Income and the debt component of AFUDC as a reduction to Interest Expense.

### ***Valuation of Nonderivative Financial Instruments***

The book values of Accounts Receivable and Accounts Payable approximate fair value because of the short-term maturity of these instruments.

### ***Revenue Recognition and Accounts Receivable***

Under terms of the unit power agreement, AEGCo accumulates all expenses monthly and prepares bills for its affiliates. In the month the expenses are incurred, AEGCo recognizes the billing revenues and establishes receivables from the affiliate companies.

### ***Maintenance***

Maintenance costs are expensed as incurred.

### ***Income Taxes and Investment Tax Credits***

AEGCo uses the liability method of accounting for income taxes. Under the liability method, deferred income taxes are provided for all temporary differences between the book and tax basis of assets and liabilities which will result in a future tax consequence.

When the flow-through method of accounting for temporary differences is reflected in regulated revenues (that is, when deferred taxes are not included in the cost of service for determining regulated rates for electricity), deferred income taxes are recorded and related regulatory assets and liabilities are established to match the regulated revenues and tax expense.

Investment tax credits are accounted for under the flow-through method except where regulatory commissions have reflected investment tax credits in the rate-making process on a deferral basis. Investment tax credits that have been deferred are amortized over the life of the plant investment.

AEGCo accounts for uncertain tax positions in accordance with the accounting guidance for "Income Taxes." AEGCo classifies interest expense or income related to uncertain tax positions as interest expense or income as appropriate and classifies penalties as Other Operation.

### ***Debt***

Gains and losses from the reacquisition of debt used to finance AEGCo's plants are deferred and amortized over the remaining term of the reacquired debt in accordance with their rate-making treatment unless the debt is refinanced. If the reacquired debt is refinanced, the reacquisition costs are generally deferred and amortized over the term of the replacement debt consistent with its recovery in rates.

Debt discount and debt issuance expenses are deferred and amortized generally utilizing the straight-line method over the term of the related debt. The straight-line method approximates the effective interest method and is consistent with the treatment in rates for regulated operations. The net amortization expense is included in Interest Expense.

### ***Earnings Per Share (EPS)***

AEGCo is a wholly-owned subsidiary of AEP. Therefore, AEGCo is not required to report EPS.

### ***Subsequent Events***

Management reviewed subsequent events through February 25, 2011, the date that AEGCo's 2010 annual report was issued.

## 2. EFFECTS OF REGULATION

Regulatory assets and liabilities are comprised of the following items:

Regulatory Assets:	December 31,		Remaining Recovery Period
	2010	2009	
	(in thousands)		
<b>Noncurrent Regulatory Assets</b>			
<b>Regulatory assets not yet being recovered pending future proceedings to determine the recovery method and timing:</b>			
<u>Regulatory Assets Currently Not Earning a Return</u>			
Asset Retirement Obligation	\$ 2,232	\$ 1,908	
<b>Total Regulatory Assets Not Yet Being Recovered</b>	<u>2,232</u>	<u>1,908</u>	
<b>Regulatory assets being recovered:</b>			
<u>Regulatory Assets Currently Earning a Return</u>			
Unamortized Loss on Reacquired Debt	3,073	3,310	6 years
<u>Regulatory Assets Currently Not Earning a Return</u>			
Income Taxes, Net	11,389	9,211	18 years
<b>Total Regulatory Assets Being Recovered</b>	<u>14,462</u>	<u>12,521</u>	
<b>Total Noncurrent Regulatory Assets</b>	<u>\$ 16,694</u>	<u>\$ 14,429</u>	
	December 31,		Remaining Refund Period
	2010 2009		
	(in thousands)		
<b>Regulatory Liabilities:</b>			
<b>Noncurrent Regulatory Liabilities and Deferred Investment Tax Credits</b>			
<b>Regulatory liabilities being paid:</b>			
<u>Regulatory Liabilities Currently Paying a Return</u>			
Deferred Investment Tax Credits	\$ 26,101	\$ 29,384	12 years
Asset Removal Costs	28,645	26,743	(a)
<b>Total Noncurrent Regulatory Liabilities and Deferred Investment Tax Credits</b>	<u>\$ 54,746</u>	<u>\$ 56,127</u>	

(a) Relieved as removal costs are incurred.

## 3. COMMITMENTS, GUARANTEES AND CONTINGENCIES

AEGCo is subject to certain claims and legal actions arising in its ordinary course of business. In addition, AEGCo's business activities are subject to extensive governmental regulation related to public health and the environment. The ultimate outcome of such pending or potential litigation cannot be predicted. For current proceedings not specifically discussed below, management does not anticipate that the liabilities, if any, arising from such proceedings would have a material adverse effect on the financial statements.

### COMMITMENTS

AEGCo has substantial construction commitments to support its operations and environmental investments. In managing the overall construction program and in the normal course of business, AEGCo contractually commits to third-party construction vendors for certain material purchases and other construction services. Management forecasts approximately \$122 million of construction expenditures excluding AFUDC for 2011. AEGCo also purchases fuel, materials, supplies, services and property, plant and equipment under contract as part of its normal course of business. Certain supply contracts contain penalty provisions for early termination.

The following table summarizes AEGCo's actual contractual commitments at December 31, 2010:

<u>Contractual Commitments</u>	<u>Less Than 1 year</u>	<u>2-3 years</u>	<u>4-5 years</u>	<u>After 5 years</u>	<u>Total</u>
	(in millions)				
Fuel Purchase Contracts (a)	\$ 0.8	\$ -	\$ -	\$ -	\$ 0.8

(a) Represents contractual commitments to purchase natural gas as fuel for electric generation along with related transportation of the fuel.

## GUARANTEES

Liabilities for guarantees are recorded in accordance with the accounting guidance for "Guarantees." There is no collateral held in relation to any guarantees. In the event any guarantee is drawn, there is no recourse to third parties.

### *Indemnifications and Other Guarantees*

#### *Contracts*

AEGCo enters into certain types of contracts which require indemnifications. Typically these contracts include, but are not limited to, sale agreements, lease agreements, purchase agreements and financing agreements. Generally, these agreements may include, but are not limited to, indemnifications around certain tax, contractual and environmental matters. With respect to sale agreements, exposure generally does not exceed the sale price. There are no material liabilities recorded for any indemnifications.

## CONTINGENCIES

### *Insurance and Potential Losses*

AEGCo maintains insurance coverage normal and customary for an electric utility, subject to various deductibles. Insurance coverage includes all risks of physical loss or damage to assets, subject to insurance policy conditions and exclusions. Covered property generally includes power plants, substations, facilities and inventories. The insurance programs also generally provide coverage against loss arising from certain claims made by third parties and are in excess of AEGCo's retentions. Coverage is generally provided by a combination of the protected cell of EIS and/or various industry mutual and/or commercial carriers.

Some potential losses or liabilities may not be insurable or the amount of insurance carried may not be sufficient to meet potential losses and liabilities. Future losses or liabilities, if they occur, which are not completely insured, unless recovered from customers, could have a material adverse effect on net income, cash flows and financial condition.

### *Carbon Dioxide Public Nuisance Claims*

In 2004, eight states and the City of New York filed an action in Federal District Court for the Southern District of New York against AEP, AEPSC, Cinergy Corp, Xcel Energy, Southern Company and Tennessee Valley Authority. The Natural Resources Defense Council, on behalf of three special interest groups, filed a similar complaint against the same defendants. The actions allege that CO<sub>2</sub> emissions from the defendants' power plants constitute a public nuisance under federal common law due to impacts of global warming and sought injunctive relief in the form of specific emission reduction commitments from the defendants. The trial court dismissed the lawsuits.

In September 2009, the Second Circuit Court of Appeals issued a ruling on appeal remanding the cases to the Federal District Court for the Southern District of New York. The Second Circuit held that the issues of climate change and global warming do not raise political questions and that Congress' refusal to regulate CO<sub>2</sub> emissions does not mean that plaintiffs must wait for an initial policy determination by Congress or the President's administration to secure the relief sought in their complaints. The court stated that Congress could enact comprehensive legislation to regulate CO<sub>2</sub> emissions or that the Federal EPA could regulate CO<sub>2</sub> emissions under

existing Clean Air Act authorities and that either of these actions could override any decision made by the district court under federal common law. The Second Circuit did not rule on whether the plaintiffs could proceed with their state common law nuisance claims. In December 2010, the defendants' petition for review by the U.S. Supreme Court was granted. Briefing is underway and the case will be heard in April 2011. Management believes the actions are without merit and intends to continue to defend against the claims.

In October 2009, the Fifth Circuit Court of Appeals reversed a decision by the Federal District Court for the District of Mississippi dismissing state common law nuisance claims in a putative class action by Mississippi residents asserting that CO<sub>2</sub> emissions exacerbated the effects of Hurricane Katrina. The Fifth Circuit held that there was no exclusive commitment of the common law issues raised in plaintiffs' complaint to a coordinate branch of government and that no initial policy determination was required to adjudicate these claims. The court granted petitions for rehearing. An additional recusal left the Fifth Circuit without a quorum to reconsider the decision and the appeal was dismissed, leaving the district court's decision in place. Plaintiffs filed a petition with the U.S. Supreme Court asking the court to remand the case to the Fifth Circuit and reinstate the panel decision. The petition was denied in January 2011.

Management is unable to determine a range of potential losses that are reasonably possible of occurring.

### ***Alaskan Villages' Claims***

In 2008, the Native Village of Kivalina and the City of Kivalina, Alaska filed a lawsuit in Federal Court in the Northern District of California against AEP, AEPSC and 22 other unrelated defendants including oil and gas companies, a coal company and other electric generating companies. The complaint alleges that the defendants' emissions of CO<sub>2</sub> contribute to global warming and constitute a public and private nuisance and that the defendants are acting together. The complaint further alleges that some of the defendants, including AEP, conspired to create a false scientific debate about global warming in order to deceive the public and perpetuate the alleged nuisance. The plaintiffs also allege that the effects of global warming will require the relocation of the village at an alleged cost of \$95 million to \$400 million. In October 2009, the judge dismissed plaintiffs' federal common law claim for nuisance, finding the claim barred by the political question doctrine and by plaintiffs' lack of standing to bring the claim. The judge also dismissed plaintiffs' state law claims without prejudice to refile in state court. The plaintiffs appealed the decision. Briefing is complete and no date has been set for oral argument. The defendants requested that the court defer setting this case for oral argument until after the Supreme Court issues its decision in the CO<sub>2</sub> public nuisance case discussed above. Management believes the action is without merit and intends to defend against the claims. Management is unable to determine a range of potential losses that are reasonably possible of occurring.

### ***The Comprehensive Environmental Response Compensation and Liability Act (Superfund) and State Remediation***

By-products from the generation of electricity include materials such as ash, slag and sludge. Coal combustion by-products, which constitute the overwhelming percentage of these materials, are typically treated and deposited in captive disposal facilities or are beneficially utilized. In addition, AEGCo's generating plants and transmission facilities have used asbestos, polychlorinated biphenyls and other hazardous and nonhazardous materials. AEGCo currently incurs costs to dispose of these substances safely.

Superfund addresses clean-up of hazardous substances that have been released to the environment. The Federal EPA administers the clean-up programs. Several states have enacted similar laws. Superfund does not recognize compliance as a defense, but imposes strict liability on parties who fall within its broad statutory categories. Present estimates do not anticipate material cleanup costs.

## **4. BUSINESS SEGMENTS**

AEGCo has one reportable segment, an electricity generation business. AEGCo's other activities are insignificant.

## 5. FAIR VALUE MEASUREMENTS

### *Fair Value Measurements of Long-term Debt*

The fair values of Long-term Debt are based on quoted market prices, without credit enhancements, for the same or similar issues and the current interest rates offered for instruments with similar maturities. These instruments are not marked-to-market. The estimates presented are not necessarily indicative of the amounts that could be realized in a current market exchange.

The book values and fair values of AEGCo's Long-term Debt as of December 31, 2010 and 2009 are summarized in the following table:

	December 31,			
	2010		2009	
	<u>Book Value</u>	<u>Fair Value</u>	<u>Book Value</u>	<u>Fair Value</u>
	(in thousands)			
Long-term Debt	\$ 326,347	\$ 341,036	\$ 333,587	\$ 338,602

## 6. INCOME TAXES

The details of income taxes as reported are as follows:

	Years Ended December 31,		
	2010	2009	2008
	(in thousands)		
Income Tax Expense (Credit):			
Current	\$ 12,984	\$ (19,455)	\$ 13,241
Deferred	(479)	27,884	(2,277)
Deferred Investment Tax Credits	(3,282)	(3,283)	(3,272)
<b>Total Income Taxes</b>	<u>\$ 9,223</u>	<u>\$ 5,146</u>	<u>\$ 7,692</u>

The following is a reconciliation of the difference between the amount of federal income taxes computed by multiplying book income before income taxes by the federal statutory rate and the amount of income taxes reported.

	Years Ended December 31,		
	2010	2009	2008
	(in thousands)		
Net Income	\$ 18,640	\$ 28,791	\$ 31,567
Income Taxes	9,223	5,146	7,692
<b>Pretax Income</b>	<u>\$ 27,863</u>	<u>\$ 33,937</u>	<u>\$ 39,259</u>
Income Taxes on Pretax Income at Statutory Rate (35%)	\$ 9,752	\$ 11,878	\$ 13,741
Increase (Decrease) in Income Taxes resulting from the following items:			
Depreciation	2,162	(105)	(677)
AFUDC	(1,133)	(2,906)	(3,269)
Rockport Plant Unit 2 Investment Tax Credit	374	374	374
Investment Tax Credits, Net	(3,282)	(3,283)	(3,272)
State and Local Income Taxes	723	(1,171)	1,431
Other	627	359	(636)
<b>Total Income Taxes</b>	<u>\$ 9,223</u>	<u>\$ 5,146</u>	<u>\$ 7,692</u>
<b>Effective Income Tax Rate</b>	33.1 %	15.2 %	19.6 %

The following table shows elements of the net deferred tax liability and significant temporary differences:

	<b>December 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>(in thousands)</b>	
Deferred Tax Assets	\$ 47,160	\$ 50,508
Deferred Tax Liabilities	(112,168)	(114,723)
<b>Net Deferred Tax Liabilities</b>	<b>\$ (65,008)</b>	<b>\$ (64,215)</b>
Property-Related Temporary Differences	\$ (83,712)	\$ (85,005)
Amounts Due from Customers for Future Federal Income Taxes	(1,984)	(1,430)
Deferred State Income Taxes	(5,700)	(5,185)
Net Deferred Gain on Sale and Leaseback – Rockport Plant Unit 2	22,603	24,218
All Other, Net	3,785	3,187
<b>Net Deferred Tax Liabilities</b>	<b>\$ (65,008)</b>	<b>\$ (64,215)</b>

AEGCo joins in the filing of a consolidated federal income tax return with its affiliates in the AEP System. The allocation of the AEP System’s current consolidated federal income tax to the AEP System companies allocates the benefit of current tax losses to the AEP System companies giving rise to such losses in determining their current tax expense. The tax benefit of the Parent is allocated to its subsidiaries with taxable income. With the exception of the loss of the Parent, the method of allocation reflects a separate return result for each company in the consolidated group.

AEGCo and other AEP subsidiaries are no longer subject to U.S. federal examination for years before 2001. AEGCo and other AEP subsidiaries have completed the exam for the years 2001 through 2006 and have issues that are being pursued at the appeals level. The years 2007 and 2008 are currently under examination. Although the outcome of tax audits is uncertain, in management’s opinion, adequate provisions for federal income taxes have been made for potential liabilities resulting from such matters. In addition, AEGCo accrues interest on these uncertain tax positions. Management is not aware of any issues for open tax years that upon final resolution are expected to have a material adverse effect on net income.

AEGCo, along with other AEP subsidiaries, files income tax returns in various state and local jurisdictions. These taxing authorities routinely examine the tax returns and AEGCo and other AEP subsidiaries are currently under examination in several state and local jurisdictions. Management believes that previously filed tax returns have positions that may be challenged by these tax authorities. However, management believes that adequate provisions for income taxes have been made for potential liabilities resulting from such challenges and that the ultimate resolution of these audits will not materially impact net income. With few exceptions, AEGCo is no longer subject to state or local income tax examinations by tax authorities for years before 2000.

AEGCo sustained federal, state and local net income tax operating losses in 2009 driven primarily by bonus depreciation, a change in tax accounting method related to units of property and other book versus tax temporary differences. As a result, AEGCo accrued current federal, state and local income tax benefits in 2009. AEGCo realized the federal cash flow benefit in 2010 as there was sufficient capacity in prior periods to carry the consolidated federal net operating loss back. Most of AEGCo’s state and local jurisdictions do not provide for a net operating loss carry back, however it is anticipated that future taxable income will be sufficient to realize the tax benefit. As such, management has determined that a valuation allowance is unnecessary.

AEGCo recognizes interest accruals related to uncertain tax positions in interest income or expense as applicable, and penalties in Other Operation in accordance with the accounting guidance for “Income Taxes.”

The following table shows amounts reported for interest expense, interest income and reversal of prior period interest expense:

	<b>Year Ended December 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>(in thousands)</b>		
Interest Expense	\$ -	\$ -	\$ 97
Interest Income	40	66	134
Reversal of Prior Period Interest Expense	3	-	-

The following table shows balances for amounts accrued for the receipt of interest and the payment of interest and penalties:

	<b>Year Ended December 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>(in thousands)</b>	
Accrual for Receipt of Interest	\$ 391	\$ 266
Accrual for Payment of Interest and Penalties	82	201

The reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	<b>2010</b>	<b>2009</b>	<b>2008</b>
		<b>(in thousands)</b>	
<b>Balance at January 1,</b>	\$ (622)	\$ (672)	\$ (485)
Increase - Tax Positions Taken During a Prior Period	1,047	263	-
Decrease - Tax Positions Taken During a Prior Period	(110)	(224)	(608)
Increase - Tax Positions Taken During the Current Year	-	11	509
Decrease - Tax Positions Taken During the Current Year	(65)	-	(88)
Increase - Settlements with Taxing Authorities	-	-	-
Decrease - Lapse of the Applicable Statute of Limitations	-	-	-
<b>Balance at December 31,</b>	<b>\$ 250</b>	<b>\$ (622)</b>	<b>\$ (672)</b>

The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate is \$(24) thousand, \$9 thousand and \$51 thousand for 2010, 2009 and 2008, respectively. Management believes there will be no significant net increase or decrease in unrecognized tax benefits within 12 months of the reporting date.

### ***Federal Tax Legislation***

The American Recovery and Reinvestment Tax Act of 2009 provided for several new grant programs and expanded tax credits and an extension of the 50% bonus depreciation provision enacted in the Economic Stimulus Act of 2008. The enacted provisions did not have a material impact on AEGCo's net income or financial condition. However, the bonus depreciation contributed to AEP's 2009 federal net operating tax loss and resulted in a 2010 cash flow benefit to AEGCo of approximately \$7 million.

The Small Business Jobs Act (the Act) was enacted in September 2010. Included in the Act was a one-year extension of the 50% bonus depreciation provision. The Tax Relief, Unemployment Insurance Reauthorization and the Job Creation Act of 2010 extended the life of research and development, employment and several energy tax credits originally scheduled to expire at the end of 2010. In addition, the Act extended the time for claiming bonus depreciation and increased the deduction to 100% for part of 2010 and 2011. The enacted provisions will not have a material impact on AEGCo's net income or financial condition but had a favorable impact on cash flows of approximately \$2 million in 2010.

## State Tax Legislation

In March 2008, legislation was signed providing for, among other things, a reduction in the West Virginia corporate income tax rate from 8.75% to 8.5% beginning in 2009. The corporate income tax rate could also be reduced to 7.75% in 2012 and 7% in 2013 contingent upon the state government achieving certain minimum levels of shortfall reserve funds. Management has evaluated the impact of the law change and the application of the law change will not materially impact AEGCo's net income, cash flows or financial condition.

## 7. LEASES

Leases of property, plant and equipment are for periods up to 33 years and require payments of related property taxes, maintenance and operating costs. The majority of the leases have purchase or renewal options and will be renewed or replaced by other leases.

Lease rentals for both operating and capital leases are generally charged to Other Operation and Maintenance expense in accordance with rate-making treatment for regulated operations. The components of rental costs are as follows:

Lease Rental Costs	Years Ended December 31,		
	2010	2009	2008
		(in thousands)	
Net Lease Expense on Operating Leases	\$ 72,271	\$ 72,588	\$ 72,506
Amortization of Capital Leases	378	358	350
Interest on Capital Leases	654	641	689
<b>Total Lease Rental Costs</b>	<u>\$ 73,303</u>	<u>\$ 73,587</u>	<u>\$ 73,545</u>

The following table shows the property, plant and equipment under capital leases and related obligations recorded on AEGCo's Balance Sheets. Capital lease obligations are included in Other Current Liabilities and Deferred Credits and Other Noncurrent Liabilities on AEGCo's Balance Sheets.

Property, Plant and Equipment Under Capital Leases	December 31,	
	2010	2009
	(in thousands)	
Generation	\$ 13,256	\$ 12,246
Other Property, Plant and Equipment	369	371
<b>Total Property, Plant and Equipment Under Capital Leases</b>	<u>13,625</u>	<u>12,617</u>
Accumulated Amortization	1,655	1,626
<b>Net Property, Plant and Equipment Under Capital Leases</b>	<u>\$ 11,970</u>	<u>\$ 10,991</u>
<b>Obligations Under Capital Leases</b>		
Noncurrent Liability	\$ 11,383	\$ 10,636
Liability Due Within One Year	587	355
<b>Total Obligations Under Capital Leases</b>	<u>\$ 11,970</u>	<u>\$ 10,991</u>

Future minimum lease payments consisted of the following at December 31, 2010:

Future Minimum Lease Payments	Capital Leases	Noncancelable Operating Leases
	(in thousands)	
2011	\$ 1,230	\$ 77,199
2012	1,213	75,164
2013	1,148	75,143
2014	1,109	75,137
2015	1,109	74,576
Later Years	12,650	517,168
<b>Total Future Minimum Lease Payments</b>	<u>\$ 18,459</u>	<u>\$ 894,387</u>
Less Estimated Interest Element	6,489	
<b>Estimated Present Value of Future Minimum Lease Payments</b>	<u>\$ 11,970</u>	

## Rockport Lease

AEGCo and I&M entered into a sale-and-leaseback transaction in 1989 with Wilmington Trust Company (Owner Trustee), an unrelated, unconsolidated trustee for Rockport Plant Unit 2 (the Plant). The Owner Trustee was capitalized with equity from six owner participants with no relationship to AEP or any of its subsidiaries and debt from a syndicate of banks and securities in a private placement to certain institutional investors.

The gain from the sale was deferred and is being amortized over the term of the lease, which expires in 2022. The Owner Trustee owns the Plant and leases it to AEGCo and I&M. The lease is accounted for as an operating lease with the payment obligations included in the future minimum lease payments schedule earlier in this note. The lease term is for 33 years with potential renewal options. At the end of the lease term, AEGCo and I&M have the option to renew the lease or the Owner Trustee can sell the Plant. Neither AEGCo, I&M nor AEP has an ownership interest in the Owner Trustee and do not guarantee its debt. AEGCo's future minimum lease payments for this sale-and-leaseback transaction as of December 31, 2010 are as follows:

<u>Future Minimum Lease Payments</u>	<u>(in millions)</u>
2011	\$ 74
2012	74
2013	74
2014	74
2015	74
Later Years	517
<b>Total Future Minimum Lease Payments</b>	<b>\$ 887</b>

## 8. FINANCING ACTIVITIES

### Long-term Debt

There are certain limitations on establishing liens against AEGCo's assets under its indentures. None of the long-term debt obligations of AEGCo have been guaranteed or secured by AEP or any of its affiliates.

The following details long-term debt outstanding as of December 31, 2010 and 2009:

<u>Type of Debt</u>	<u>Maturity</u>	<u>Interest Rate at December 31,</u>		<u>Outstanding at</u>	
		<u>2010</u>	<u>2009</u>	<u>December 31,</u>	<u>2009</u>
				<u>(in thousands)</u>	
Senior Unsecured Notes	2037	6.33%	6.33%	\$ 196,364	\$ 203,637
Pollution Control Bonds (a)	2011 (b)	4.15%	4.15%	45,000	45,000
Other Long-term Debt	2011	1.3125%	1.25%	85,000	85,000
Unamortized Discount (net)				(17)	(50)
<b>Total Long-term Debt Outstanding</b>				<u>326,347</u>	<u>333,587</u>
<b>Less Portion Due Within One Year</b>				<u>137,273</u>	<u>7,273</u>
<b>Long-term Portion</b>				<u>\$ 189,074</u>	<u>\$ 326,314</u>

- (a) For AEGCo's pollution control bonds, interest rates are subject to periodic adjustment and may be purchased on demand at periodic interest adjustment dates. Standby bond purchase agreements and insurance policies support certain series.
- (b) AEGCo's pollution control bonds are subject to mandatory redemption earlier than the maturity date. Consequently, these bonds have been classified for maturity and repayment purposes based on the mandatory redemption date.

Long-term debt outstanding at December 31, 2010 is payable as follows:

	2011	2012	2013	2014	2015	After 2015	Total
	(in thousands)						
Principal Amount	\$ 137,273	\$ 7,273	\$ 7,273	\$ 7,273	\$ 7,273	\$ 159,999	\$ 326,364
Unamortized Discount							(17)
<b>Total Long-term Debt Outstanding</b>							<u>\$ 326,347</u>

### **Dividend Restrictions**

#### *Federal Power Act*

The Federal Power Act prohibits AEGCo from participating “in the making or paying of any dividends of such public utility from any funds properly included in capital account.” The term “capital account” is not defined in the Federal Power Act or its regulations. Management understands “capital account” to mean the par value of the common stock multiplied by the number of shares outstanding. This restriction does not limit the ability of AEGCo to pay dividends out of retained earnings.

#### *Utility Money Pool – AEP System*

The AEP System uses a corporate borrowing program to meet the short-term borrowing needs of its subsidiaries. The corporate borrowing program includes a Utility Money Pool, which funds the utility subsidiaries. The AEP System Utility Money Pool operates in accordance with the terms and conditions approved in a regulatory order. The amount of outstanding borrowings from the Utility Money Pool as of December 31, 2010 and 2009 is included in Advances from Affiliates on AEGCo’s balance sheets. AEGCo’s Utility Money Pool activity and corresponding authorized borrowing limits for the years ended December 31, 2010 and 2009 are described in the following table:

Year	Maximum Borrowings from Utility Money Pool	Maximum Loans to Utility Money Pool	Average Borrowings from Utility Money Pool	Average Loans to Utility Money Pool	Borrowings from Utility Money Pool as of December 31,	Authorized Short-Term Borrowing Limit
	(in thousands)					
2010	\$ 113,578	\$ -	\$ 61,638	\$ -	\$ 21,178	\$ 200,000
2009	89,736	-	56,361	-	80,168	200,000

Maximum, minimum and average interest rates for funds either borrowed from or loaned to the Utility Money Pool for the years ended December 31, 2010, 2009 and 2008 are summarized in the following table:

Years Ended December 31,	Maximum Interest Rates for Funds Borrowed from Utility Money Pool	Minimum Interest Rates for Funds Borrowed from Utility Money Pool	Maximum Interest Rates for Funds Loaned to Utility Money Pool	Minimum Interest Rates for Funds Loaned to Utility Money Pool	Average Interest Rates for Funds Borrowed from Utility Money Pool	Average Interest Rates for Funds Loaned to Utility Money Pool
2010	0.55 %	0.09 %	- %	- %	0.27 %	- %
2009	2.28 %	0.15 %	- %	- %	0.80 %	- %
2008	5.47 %	2.28 %	- %	- %	4.75 %	- %

Interest expense and interest income related to the Utility Money Pool are included in Interest Expense and Interest Income, respectively, on AEGCo's Statements of Income. For amounts borrowed from and advanced to the Utility Money Pool, AEGCo incurred the following amounts of interest expense and earned the following amounts of interest income, respectively, for the years ended December 31, 2010, 2009 and 2008:

	<b>Years Ended December 31,</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
	<b>(in thousands)</b>		
Interest Expense	\$ 167	\$ 458	\$ 2,967
Interest Income	-	-	-

## **9. RELATED PARTY TRANSACTIONS**

For other related party transactions, also see "Utility Money Pool – AEP System" section of Note 8.

### ***Affiliated Revenues***

AEGCo's revenues derived from sales to affiliates for the years ended December 31, 2010, 2009 and 2008 were \$451 million, \$415 million and \$468 million, respectively. These revenues are reported as Operating Revenues on AEGCo's Statements of Income.

### ***Unit Power Agreements (UPA)***

#### ***Lawrenceburg UPA between CSPCo and AEGCo***

In March 2007, CSPCo and AEGCo entered into a 10-year UPA for the entire output from the Lawrenceburg Generating Station effective with AEGCo's purchase of the plant in May 2007. The UPA has an option for an additional 2-year period. I&M operates the plant under an agreement with AEGCo. Under the UPA, CSPCo pays AEGCo for the capacity, depreciation, fuel, operation and maintenance and tax expenses. These payments are due regardless of whether the plant is operating. The fuel and operation and maintenance payments are based on actual costs incurred. All expenses are trued up periodically.

#### ***UPA between AEGCo and I&M***

A UPA between AEGCo and I&M (the I&M Power Agreement) provides for the sale by AEGCo to I&M of all the power (and the energy associated therewith) available to AEGCo at the Rockport Plant unless it is sold to another utility. I&M is obligated, whether or not power is available from AEGCo, to pay as a demand charge for the right to receive such power (and as an energy charge for any associated energy taken by I&M) net of amounts received by AEGCo from any other sources, sufficient to enable AEGCo to pay all its operating and other expenses, including a rate of return on the common equity of AEGCo as approved by the FERC. The I&M Power Agreement will continue in effect until the expiration of the lease term of Unit 2 of the Rockport Plant unless extended in specified circumstances.

#### ***UPA between AEGCo and KPCo***

Pursuant to an assignment between I&M and KPCo and a UPA between KPCo and AEGCo, AEGCo sells KPCo 30% of the power (and the energy associated therewith) available to AEGCo from both units of the Rockport Plant. KPCo pays to AEGCo in consideration for the right to receive such power the same amounts which I&M would have paid AEGCo under the terms of the I&M Power Agreement for such entitlement. The KPCo UPA ends in December 2022.

### ***I&M Barging and Other Services***

I&M provides barging and other transportation services to affiliates. AEGCo recorded costs of \$13 million, \$13 million and \$17 million for the years ended December 31, 2010, 2009 and 2008, respectively, for barging services provided by I&M. These costs were recorded as Fuel Used for Electric Generation on AEGCo's Statements of Income.

### ***Central Machine Shop***

APCo operates a facility which repairs and rebuilds specialized components for the generation plants across the AEP System. APCo defers on its balance sheet the cost of performing the services, then transfers the cost to the affiliate for reimbursement. AEGCo recorded these billings as capital or maintenance expense depending on the nature of the services received. These billings are recoverable under the UPAs. AEGCo's billed amounts were \$180 thousand, \$31 thousand and \$138 thousand for the years ended December 31, 2010, 2009 and 2008, respectively.

### ***Sales of Property***

AEGCo had affiliated sales of electric property individually amounting to \$100 thousand or more for the year ended December 31, 2010 of \$332 thousand to APCo and \$190 thousand to OPCo. AEGCo did not have affiliated sales of property during 2009 or 2008.

### ***Variable Interest Entities***

The accounting guidance for "Variable Interest Entities" is a consolidation model that considers if a company has a controlling financial interest in a VIE. A controlling financial interest will have both (a) the power to direct the activities of a VIE that most significantly impact the VIE's economic performance and (b) the obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE. Entities are required to consolidate a VIE when it is determined that they have a controlling financial interest in a VIE and therefore, are the primary beneficiary of that VIE, as defined by the accounting guidance for "Variable Interest Entities." In determining whether AEGCo is the primary beneficiary of a VIE, management considers factors such as equity at risk, the amount of the VIE's variability AEGCo absorbs, guarantees of indebtedness, voting rights including kick-out rights, power to direct the VIE and other factors. Management believes that significant assumptions and judgments were applied consistently. There have been no changes to the reporting of VIEs in the financial statements where it is concluded that AEGCo is the primary beneficiary. In addition, AEGCo has not provided financial or other support to any VIE that was not previously contractually required.

AEPSC provides certain managerial and professional services to AEGCo and other subsidiaries. AEP is the sole equity owner of AEPSC. AEP management controls the activities of AEPSC. The costs of the services are based on a direct charge or on a prorated basis and billed to AEGCo and other AEP subsidiaries at AEPSC's cost. AEGCo and other subsidiaries have not provided financial or other support outside the reimbursement of costs for services rendered. AEPSC finances its operations through cost reimbursement from other AEP subsidiaries. There are no other terms or arrangements between AEPSC and AEGCo and other subsidiaries that could require additional financial support from AEGCo and other subsidiaries or expose them to losses outside of the normal course of business. AEPSC and its billings are subject to regulation by the FERC. AEGCo and other subsidiaries are exposed to losses to the extent they cannot recover the costs of AEPSC through their normal business operations. AEGCo is considered to have a significant interest in AEPSC due to its activity in AEPSC's cost reimbursement structure. However, AEGCo does not have control over AEPSC. AEPSC is consolidated by AEP. In the event AEPSC would require financing or other support outside the cost reimbursement billings, this financing would be provided by AEP. Total billings from AEPSC for the years ended December 31, 2010, 2009 and 2008 were \$11 million, \$11 million and \$10 million, respectively. The carrying amount of liabilities associated with AEPSC for the years ended December 31, 2010 and 2009 were \$1.1 million and \$690 thousand, respectively. Management estimates the maximum exposure of loss to be equal to the amount of such liability.

## 10. PROPERTY, PLANT AND EQUIPMENT

### Depreciation

AEGCo provides for depreciation of Property, Plant and Equipment on a straight-line basis over the estimated useful lives of property, generally using composite rates by functional class. The following table provides the annual composite depreciation rates by functional class:

2010		Regulated			Nonregulated			
Functional Class of Property	Property, Plant and Equipment	Accumulated Depreciation	Annual Composite	Depreciable Life Ranges	Property, Plant and Equipment	Accumulated Depreciation	Annual Composite	Depreciable Life Ranges
			Depreciation Rate				Depreciation Rate	
		(in thousands)		(in years)	(in thousands)		(in years)	
Generation	\$ 1,455,131	\$ 874,304	2.5%	31-37	\$ -	\$ -	-	-
Transmission	9,688	4,611	1.5%	N.M.	-	-	-	-
CWIP	228,794	(20)	N.M.	N.M.	-	-	-	-
Other	8,695	2,787	12.5%	N.M.	44	-	N.M.	N.M.
<b>Total</b>	<b>\$ 1,702,308</b>	<b>\$ 881,682</b>			<b>\$ 44</b>	<b>\$ -</b>		

2009		Regulated			Nonregulated			
Functional Class of Property	Property, Plant and Equipment	Accumulated Depreciation	Annual Composite	Depreciable Life Ranges	Property, Plant and Equipment	Accumulated Depreciation	Annual Composite	Depreciable Life Ranges
			Depreciation Rate				Depreciation Rate	
		(in thousands)		(in years)	(in thousands)		(in years)	
Generation	\$ 1,443,263	\$ 838,826	2.4%	31-37	\$ -	\$ -	-	-
Transmission	9,688	4,535	1.5%	46-75	-	-	-	-
CWIP	227,315	1,532	N.M.	N.M.	-	-	-	-
Other	7,775	3,803	10.7%	N.M.	45	-	N.M.	N.M.
<b>Total</b>	<b>\$ 1,688,041</b>	<b>\$ 848,696</b>			<b>\$ 45</b>	<b>\$ -</b>		

2008		Regulated		Nonregulated	
Functional Class of Property		Annual Composite	Depreciable Life Ranges	Annual Composite	Depreciable Life Ranges
		Depreciation Rate		Depreciation Rate	
		(in years)		(in years)	
Generation		2.4%	31-37	-	-
Transmission		-	-	-	-
CWIP		N.M.	N.M.	-	-
Other		8.4%	N.M.	N.M.	N.M.

N.M. Not Meaningful

The composite depreciation rate generally includes a component for nonasset retirement obligation (non-ARO) removal costs, which is credited to Accumulated Depreciation and Amortization. Actual removal costs incurred are charged to Accumulated Depreciation and Amortization. Any excess of accrued non-ARO removal costs over actual removal costs incurred is reclassified from Accumulated Depreciation and Amortization and reflected as a regulatory liability.

### ***Asset Retirement Obligations (ARO)***

AEGCo records ARO in accordance with the accounting guidance for “Asset Retirement and Environmental Obligations” for the retirement of ash disposal facilities and asbestos removal. The following is a reconciliation of the 2010 and 2009 aggregate carrying amounts of ARO for AEGCo:

<u>Year</u>	<u>ARO at January 1,</u>	<u>Accretion Expense</u>	<u>Liabilities Incurred</u>	<u>Liabilities Settled</u>	<u>Revisions in Cash Flow Estimates</u>	<u>ARO at December 31,</u>
			(in thousands)			
2010	\$ 3,233	\$ 291	\$ 316	\$ -	\$ 364	4,204
2009	3,000	272	-	(4)	(35)	3,233

### ***Allowance for Funds Used During Construction (AFUDC)***

AEGCo’s amounts of allowance for borrowed and equity funds used during construction are summarized in the following table:

	<u>Years Ended December 31,</u>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
		(in thousands)	
Allowance for Equity Funds Used During Construction	\$ 123	\$ 5,175	\$ 6,198
Allowance for Borrowed Funds Used During Construction	61	1,932	3,250

### ***Jointly-owned Electric Facilities***

AEGCo, jointly with I&M, owns one generating unit (Unit 1) of the Rockport Plant. AEGCo and I&M each have a 50.0% ownership share of the Rockport Plant. Using its own financing, each participating company is obligated to pay its share of the costs in the same proportion as its ownership interest. AEGCo’s proportionate share of the operating costs associated with this facility is included in its Statements of Income and the investment and accumulated depreciation are reflected in its Balance Sheets under Property, Plant and Equipment at December 31, 2010 as follows:

	<u>Fuel Type</u>	<u>Percent of Ownership</u>	<u>Utility Plant in Service</u>	<u>Construction Work in Progress</u>	<u>Accumulated Depreciation</u>
				(in thousands)	
<u>AEGCo's Share at December 31, 2010</u>					
Rockport Generating Plant (Unit 1) (a)	Coal	50.0 %	\$ 744,819	\$ 25,031	\$ 500,017

(a) Operated by I&M.

## **11. COST REDUCTION INITIATIVES**

In April 2010, management began initiatives to decrease both labor and non-labor expenses with a goal of achieving significant reductions in operation and maintenance expenses. A total of 2,461 positions were eliminated across the AEP System as a result of process improvements, streamlined organizational designs and other efficiencies. Most of the affected employees terminated employment on May 31, 2010. The severance program provides two weeks of base pay for every year of service along with other severance benefits.

AEGCo recorded a charge to expense in 2010 primarily related to the headcount reduction initiatives. Management does not expect additional costs to be incurred related to this initiative.

AEGCo has no employees but receives allocated expenses.

<u>Expense Allocation</u>	<u>Incurred</u>	<u>Settled</u>	<u>Adjustments</u>	<u>Remaining Balance at December 31, 2010</u>
		(in thousands)		
\$ 3,855	\$ -	\$ 4,868	\$ 1,098	\$ 85

These costs relate primarily to severance benefits. They are included primarily in Other Operation on the Statements of Income and Other Current Liabilities on the Balance Sheets.

## **12. UNAUDITED QUARTERLY FINANCIAL INFORMATION**

In management's opinion, the unaudited quarterly information reflects all normal and recurring accruals and adjustments necessary for a fair presentation of the results of operations for interim periods. Quarterly results are not necessarily indicative of a full year's operations because of various factors. AEGCo's unaudited quarterly financial information is as follows:

	<b>2010 Quarterly Periods Ended</b>			
	<u>March 31</u>	<u>June 30</u>	<u>September 30</u>	<u>December 31</u>
	(in thousands)			
Operating Revenues	\$ 95,492	\$ 90,815	\$ 135,482	\$ 128,991 (a)
Operating Income	9,978	10,468	11,153	12,850
Net Income	4,043	4,967	5,161	4,469

  

	<b>2009 Quarterly Periods Ended</b>			
	<u>March 31</u>	<u>June 30</u>	<u>September 30</u>	<u>December 31</u>
	(in thousands)			
Operating Revenues	\$ 106,715	\$ 101,313	\$ 112,787	\$ 93,978
Operating Income	9,914	10,960	12,973	11,072
Net Income	6,911	8,623	6,504	6,753

(a) Includes \$17 million related to increased operations at the Lawrenceburg Generating Station in comparison to the fourth quarter of 2009.

There were no significant events in 2009.